No. 22087

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

A. J. Hume, as Trustee in Bankruptcy for the Estate of Thompson Electric Co., Bankrupt,

Appellant

vs

Valley Electric Company, a California corporation,

Appellee.

APPELLEE'S BRIEF.

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APPELLEE'S BRIEF.

I.

Scope of the Appeal.

The Notice of Appeal and the Appellant's Opening Brief leave uncertain the scope and basis of the appeal.

The opening statement of appellant's brief states that this is an appeal:

> *"from findings of fact, conclusions of law and judgment thereon made and entered by the Honorable Manuel Real, United States District Judge."*

The Notice of Appeal makes a similar statement.

The specification of errors states "The judgment of the United States District Court is erroneous in that

the same is based upon the following erroneous findings of fact to wit:"

Then follow quotations from the findings. The quoted findings are very incomplete.

The trial court did find by findings of the following numbers:

No. 4—That Thompson Electric Co. was not bankrupt on February 1, 1965, and was not bankrupt at all times from and after February 1, 1965.

No. 9—That at the time the payments were made to appellee, Thompson Electric Co. was not insolvent.

No. 10—That at the time those payments were made the appellee did not know and did not have reasonable cause to believe that Thompson Electric Co. was insolvent.

No. 11—That deliveries of merchandise by Appellee more than equalled the amount that was paid to it and that all of the obligations of the Appellee were paid as they fell due except the obligation to Appellee as stated. Also by Finding 11 states it is not true that defendant received a greater percentage of its claim than has or will some other creditor.

Appellant's arguments are directed to his contention of what the evidence showed. Typical is the statement of page 8 of the Brief:

> "It is submitted that a review of the evidence produced at the trial, including the pretrial conference order with its admitted facts and exhibits, conclusively shows that all elements of a voidable bankruptcy preference were proven by the trustee and that the findings of the District Court on

these points are clearly erroneous within the meaning of rule 52(a) of the Federal Rules of Civil Procedure."

While not fully clear, it does appear that the basis of the appeal is that the findings of the District Court are *"clearly erroneous"* under Rule 52(a).

Unless findings which we quote were *"clearly erroneous"* they support the judgment whatever may have been the other findings of the trial court.

II.

The Application of the Clearly Erroneous "Rule".

The applicable portion of Rule 52, subdivision (a) is as follows:

> "Findings of fact shall not be set aside unless clearly erroneous and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

In *Cataphote Corp. v. DeSoto Chemical Coatings, Inc.,* 356 F. 2d 24 (9 Cir. 1966) the attitude of the appellant was similar to the attitude here. There the court said at page 26:

> "Appellant though reluctant to characterize the issue involved as one of fact, does nevertheless ground its argument on a purported demonstration of the 'clearly erroneous' nature of the District Court's findings. In so doing, however, appellant disregards the severe limitations imposed on an appellate court in reviewing findings of fact. It is not our function to reevaluate the evidence presented below. We cannot substitute our judgment for the first hand evaluation made by the trier

of fact. Pursuant to Rule 52(a) of the Federal Rules of Civil Procedure our obligation is to determine if the findings below were 'clearly erroneous.' This statutorily imposed standard does not vest us with the power to reweigh the evidence presented at trial in an attempt to assess which item should and which should not have been accorded credibility. Our task, rather, is to determine if there exists evidence of substance to support the findings of fact of the trial court. Thus, it does not aid appellant's position on review to merely extract the evidence presented which supports his position; rather it must additionally demonstrate that no substantial evidence was presented which supports the District Court findings in favor of appellee."

The rule, stating the limitation on the appellate court, is also stated in *Friedman v. Fordyce Concrete, Inc.*, 362 F. 2d 386, where it is said at page 387:

"The basic rules to be applied in resolving the question before us are axiomatic. This court, upon review, will not retry issues of fact, neither will we substitute our judgment on such issues for that of the trial court. We are not permitted to set aside a finding of fact unless there is no substantial evidence to sustain it, unless it is against the clear weight of the evidence, or unless it was induced by an erroneous view of the law. Cleo Syrup Corporation v. Coca-Cola Co., 139 F.2d 416, 417, 150 A.L.R. 1056 (8 Cir. 1943). Findings of Fact are presumptively correct and the complaining party has the burden to clearly demonstrate that error exists in the findings of the trial court. Joseph A. Bass Company v. United States,

340 F.2d 842 (8 Cir. 1965); Warnecke v. MacDonald Construction Co. 323 F.2d 715, 716 (8 Cir. 1963); Montgomery Ward & Company v. Steele, 352 F.2d 822, 830 (8 Cir. 1965)".

In that case there was also a situation where it was contended that there was incompetent evidence admitted. The court said with reference to that at page 389:

"[10] In any event, the rule is well settled that in a non-jury case, the appellate court will not reverse the admission of incompetent evidence unless it appears that all of the competent evidence is insufficient to support the judgment, or unless it affirmatively appears that the incompetent evidence induced the court to make an essential finding which it would not otherwise have made. Joseph A. Bass Company v. United States, supra, p. 845 of 340 F.2d 842, and cases cited; Skinner v. United States, 326 F.2d 594, 597 (8 Cir. 1964).

[11] Assuming arguendo that the evidence was incompetent, it does not affirmatively appear that such evidence induced, or even influenced Judge Oliver's decision. Moreover the record abounds with competent evidence, which, as we have previously noted, provides adequate support for the court's finding of no liability."

Thus, if there is competent evidence adequate to support the court's finding, whatever else may have happened at the trial ceases to be important.

Appellant does not make sufficiently clear why he claims the findings of the trial court were erroneous for us to determine and argue the issue. However, the decision, far from being "*clearly erroneous*" was correct on the evidence presented.

III.

The True Basis of the Decision.

The pretrial statement including all of its exhibits, the complete record of the evidence including all of the accounting records and the complete findings of the trial court show that the findings are well supported by the evidence.

The factual situation is as follows:

The University of California at its Santa Barbara Campus contracted for the erection of two large buildings. On one building J. B. Allen Company, hereafter called Allen, was the general contractor. On the other building, J. W. Bailey Construction Company hereafter called Bailey, was the general contractor. Each contract was a separate contract with the University.

Each of these contractors, by separate subcontracts, then employed Thompson Electric Co. to perform work as an electrical subcontractor on its building. Thompson had two contracts each with entirely separate contractors.

Valley Electric Company, here called Valley, is a wholesale dealer in electrical goods used in performing the whole of an electrical contractor. Valley Electric, delivered materials on the order of Thompson which were then incorporated into the buildings being erected for the University by Allen and Bailey.

The sequence was; Valley delivered the materials and billed Thompson. Thompson installed the materials and billed the general contractors Bailey and Allen for the materials plus the labor plus Thompson's profit. Each of Bailey and Allen then billed the University for the Thompson work plus any other work that they had done in constructing the buildings.

In due course and after usual delays payment would take place. The University would pay Bailey and Allen and then Bailey and Allen would pay Thompson and then Thompson would pay Valley. In the meanwhile, more work would be done and more obligations would be incurred. Thus at any time the University would owe Bailey and Allen. Bailey and Allen would owe Thompson and Thompson would owe Valley. This is as is usual in building contracts with the money working down from the owner to the supplier of the materials.

Except for its debt to Valley and for a small obligation of Three Thousand Four Hundred Twenty-five Dollars and one cent ($3,425.01) incurred in March for merchandise supplied by Raber Supply Co., Thompson paid all of its debts through April of 1965. Thompson was not indebted to either Bailey or Allen.

According to the accounts which were made a part of the record, Thompson as of June 10, 1965, showed an account receivable from J. B. Allen Co. of Nine Thousand Two Hundred Fifty-six Dollars and twenty-three cents ($9,256.23) and showed accounts receivable from J. W. Bailey Construction Co. of Seventeen Thousand Two Hundred Seventy-five Dollars and Eighteen cents ($17,275.18). These obligations of Bailey and Allen to Thompson arose because Thompson using materials largely supplied by Valley, performed services for Bailey and Allen on the University buildings.

The record also shows that on June 17. 1965, Thompson owed Valley Electric One Hundred Five Thousand Seven Hundred Ninety-four Dollars and eighty-eight cents ($105,794.88) for materials furnished.

There was testimony that Thompson had dealings at Vandenberg Air Force Base with a person referred to as "Garcia". As a result of these dealings he had suffered losses and these losses caused him to be unable to complete his work on the University buildings.

In late May or early June, 1965, Thompson informed Bailey and Allen and Valley that he would be unable to complete his contracts.

Upon Thompson's announcing his inability to pay his bills and complete his work, Valley filed stop notices with the University and the University withheld payment as required by the stop notice law.

As a result of Thompson's breach of his contract each of Bailey and Allen had to find others to perform their electrical work. This created the ordinary breach of contract situation with unliquidated and completely contingent possibility of obligation from Thompson to Bailey and Allen because of the breach.

An involuntary petition of bankruptcy of Thompson Electric Company was filed on June 10, 1965, with Bailey and Allen as the principal creditors seeking the bankruptcy and one other small creditor joined in the petition. Thompson Electric Company was adjudged a bankrupt on June 29, 1965, on the basis of that involuntary petition. The bankrupt thereafter filed its schedules stated to be as of final accounting dated June 17, 1965. The schedules did not list either Bailey or Allen as creditors but did list Valley Electric Company as a creditor to which the bankrupt was indebted in the amount of One Hundred Five Thousand Five Hundred Seventy-three Dollars and fifty-seven cents ($105,-573.57) out of a total debt of One Hundred Twenty-one Thousand Two Hundred Twenty-two Dollars and

thirty-three cents ($12,222.33). The schedules showed that the bankrupt held choses in action totalling Twenty-six Thousand Nine Hundred Seventy-six Dollars and fifty-two cents ($26,976.52). The detail of that Twenty-six Thousand Nine Hundred Seventy-six Dollars and fifty-two cents ($26,976.52) is incorporated in Exhibit "O" attached to the pre-trial statement which shows that there was owed to J. B. Allen and Company on June 10, 1965, Nine Thousand Two Hundred Fifty-six Dollars and twenty-three cents ($9,256.33) and by J. W. Bailey Construction Company, Seventeen Thousand Two Hundred Seventy-five Dollars and eighteen cents ($17,275.18). No debt to either Bailey or Allen at that date was shown.

On or about July 22, 1965, Bailey agreed to pay Fifty-five Thousand One Hundred Ninety-one Dollars and two cents ($55,191.02) to Valley upon Valley releasing its stop notice. The amount was to be paid Twenty Thousand One Hundred Ninety-one Dollars and two cents ($20,191.02) on July 22, 1965, and Seven Thousand ($7,000.00) per month thereafter until the full amount was paid. Upon the agreement being made, Valley released its stop notice and the University then paid to Bailey all amounts which had been held by virtue of that stop notice.

On November 18, 1965, Allen paid to Valley the sum of Twenty-five Thousand Five Hundred Dollars ($25,500.00) in return for release by Valley in full of its stop notice of Thirty-three Thousand Four Hunded Sixty Dollars and ninety cents ($33,460.90). The stop notice was then released and Allen was paid by the University. The difference between the Twenty-five Thousand Dollars ($25,000.00) and the Thirty-three Thousand Four Hundred Sixty Dollars and ninety

cents ($33,460.90) was a negotiated discount for cash and for the agreement of Allen that it would not participate in making any claim against Valley that payments to Valley resulted in preference to Valley in the manner claimed in this action.

On August 26, 1965, Bailey filed its proof of claim in bankruptcy seeking recovery of Fifty-eight Thousand Seven Hundred Twenty-seven Dollars and ninety-seven cents ($58,727.97). That claim appears to have been largely based upon its payment to secure the release of the Valley stop notice although it also did refer to failure of the bankrupt to perform its subcontract and to the fact that the claimant had been forced to employ another electrical subcontractor with possible additional costs.

Proof of claim in bankruptcy was filed by Allen on August 26, 1965, apparently being based directly upon the Valley stop notice of Thirty-three Thousand Four Hundred Sixty Dollars and ninety cents ($33,460.90) which was later released to Allen upon the payment of Twenty-five Thousand Dollars ($25,000.00). Allen also referred to the failure of the bankrupt to perform its subcontract and the necessity of employing another electrical subcontractor.

Upon Valley Electric's stop notice claims being paid, it made no claims in bankruptcy so while it was the principal creditor with a debt of One Hundred Five Thousand Five Hundred Seventy-three Dollars and fifty-seven cents ($105,573.57) from Thompson to it, it was not a claimant in the bankruptcy.

The Schedules attached to the pre-trial statement show that if the claim of Valley is excluded the assets of Thompson exceeded its liabilities.

IV.

The Effect of the Stop Notices.

The stop notices filed by Valley were direct claims directed to the University and seeking payment from the University to Valley. They did not make Bailey and Allen creditors of Thompson. They did not establish the amount of any claim that Bailey and Allen might have against Thompson.

Under the stop notice law the University would pay directly to Valley an amount equal to the amount owed to Valley for goods furnished by Valley and incorporated in the University buildings. While it is true that the amounts thus paid would then have been deducted from payments from the University to Bailey and Allen, the filing of the stop notices created no debt from Thompson to Bailey and Allen. Payment to Valley by the University or by Bailey and Allen was not a payment by Thompson and could not result in a claim of preferential payment by Thompson to Valley. A similar situation was considered in *Keenan Pipe and Supply Company v. Shields,* 241 F. 2d 486. That case discusses the public policy protecting a materialman furnishing material to public works. The policy is stated in that case at page 489:

> "The public policy to have the laborer and materialman paid for public works jobs is much stronger

than that which underlies legislation to protect such parties on private projects, by which each is given a mechanic's lien which attaches from the time the labor or material goes into the project. But the rationale of all such legislation is the same. Therefore, a payment either by a principal contractor or a subcontractor to a materialman can be held valid either on the ground that the materialman surrendered his right to file a lien or, as here, the Stop Notice, and received the payment as present consideration therefor or, on the other hand, that a valid contract had been made between the parties, the contractor, the subcontractor and the materialman whereby the materialman gave up his right to file the Stop Notice and the contractor and subcontractor agreed that, as a consideration therefore, the checks should be given to him."

The court also said in that case at page 490:

"[5] The finding that Keenan, as a creditor, was enabled to obtain a greater percentage of his debt than some other creditor of the same class is erroneous as to such a payment, because no other creditor is shown to have been in that same position. Many months before the petition in bankruptcy was filed, Keenan was in a preferred position. The contractor was under obligation to pay for all material Keenan had furnished for the state project, and Keenan had a right to file the Stop Notice if the payment was not made. No other creditor is shown to have been in that position."

V.

The Claims of Bailey and Allen.

On June 10, 1965, Bailey owed Thompson Seventeen Thousand Two Hundred Seventy-five Dollars and eighteen cents ($17,275.18) and Allen owed Thompson Nine Thousand Two Hundred Fifty-six Dollars and twenty-three cents ($9,256.23). Thompson had announced his breach and Valley had filed its stop notices.

Bailey and Allen could pay Valley for materials furnished to their job or if they did not, the University would pay and deduct the amount paid from payments to Bailey and Allen. On June 10, 1965, neither Bailey nor Allen, nor the University had made payments however.

Bailey and Allen had to secure others to perform Thompson's work. They, however, would be relieved of their obligation to pay Thompson for work already billed and possibly for materials delivered and work done but not yet billed. In any event their only claim against Thompson would arise if there were extra cost to them from hiring others to do the work after crediting to Thompson any amounts due to him for work done and billed plus work and materials furnished by him and possibly not billed. The amount of loss to Bailey and Allen, if actually there was to be a loss could not be determined until there was a determination of the charge of the new contractor and a comparison of that with the contract price of Thompson for the same work. There may have been no loss to Bailey and Allen. We canot tell until the whole account is stated.

In any event, Bailey and Allen had received and incorporated into their buildings built for the University

the materials supplied by Valley which were the basis of the stop notices filed by Valley. Presumptively the billing to the University affected by the stop notices included billing for materials supplied by Valley.

The petition in bankruptcy filed by Bailey and Allen and their claims filed in the bankruptcy were for the amounts claimed by Valley in its stop notices to the University. Yet on June 10, 1965, when the petition was filed and even at the time the claims were filed, Bailey and Allen had not been out the money claimed by them. The validity of the claims of the creditors is important when it is claimed that another creditor has been given a preference. Here, however, no valid claims were shown.

The stop notices were not indicative of the amount of any debt of Thompson to Bailey or Allen. That was a direct claim by Valley to the University which may or may not have resulted in a loss to Bailey and Allen which would give them a claim against Thompson.

The burden of proof was upon the Plaintiff Bumb to show that there was an insolvency resulting in bankruptcy and that there was an unlawful preference of Valley over other creditors. The fact that claims had been allowed in the bankruptcy proceedings, to which Valley was not a party, in no way established, for the purposes of this action, the validity of those claims. There were no other creditors at the time when Valley received the payments objected to. That at some later

time claims were filed by others and allowed in the bankruptcy showed neither the validity of those claims nor any preference of Valley over those later claimants.

What appears to have happened is that Bailey and Allen in order to get their money from the University settled with Valley so that Valley would release its stop notices. Now having done so they, using the trustee in bankruptcy as their tool, are trying to get back from Valley the same money that they paid to Valley in settlement. Valley abandoned its claim to One Hundred Five Thousand Dollars ($105,000.00) upon being paid a substantially smaller sum on its stop notices. Now Bailey and Allen as the principal creditors of Thompson, using claims not shown to have any basis are trying to get money from Valley in the hope of recovery of that which was paid to Valley.

Valley was a secured creditor having a mechanic's lien or stop notice right, public policy has established the desirability that materialmen furnishing materials for public buildings be protected. If, upon payment of the amounts covered by their lien rights (or stop notice rights), the amounts could then be recovered from them that policy would be defeated.

Actually Bailey and Allen were never proven to be creditors of Thompson. Valey abandoned its claim. With those amounts deducted Thompson was not insolvent. There could not therefor have been an unlawful preference.

VI.

Collateral Attack Upon the Adjudication in Bankruptcy.

Appellant argues that the adjudication in bankruptcy cannot be collaterally attacked. Appellant also argues that it is immaterial whether or not Allen and Bailey were valid petitioning creditors.

The attack upon the adjudication in bankruptcy was not essential to the decision in the trial court. It is, therefore, not a basis for appeal and really immaterial here whether or not there could be a collateral attack. It is well to note, however, that the position of appellant appears to be that Allen and Bailey, who were not then in fact creditors, by filing a petition which was in fact without basis, and by securing the *"consent"* of the debtor could establish a bankruptcy and gain rights against other creditors, yet they argue that these other creditors could not, had they desired to do so, have had any place in the bankruptcy proceeding.

While it is an apparent misuse of the bankruptcy procedure to establish a bankruptcy here we, because the issue is unnecessary do not base our position upon that issue.

If respondents were and are precluded from attacking the validity of the bankruptcy order either at the time when it was made or in these proceedings because it is collateral to these proceedings, by the same reasoning whatever happened in the bankruptcy has no bearing here. That there were claims filed against the bankrupt estate and that the trustee may have liquidated all assets has no probative effect here, for if wholly collateral so that appellee cannot attack what went

on in the bankruptcy, the bankruptcy cannot create rights against the appellee.

On page 18 of appellant's brief, it is argued that the trustee has liquidated all assets of the bankrupt and has on hand Eleven Thousand Dollars ($11,000.00). Yet we know that at the time when the petition in bankruptcy was filed Bailey and Allen owed the bankrupt Twenty-six Thousand Nine Hundred Seventy-six Dollars and fifty-two cents ($26,976.52). If that was collected the assets would exceed Eleven Thousand Dollars ($11,000.00). We had no explanation.

Bailey and Allen had claims of Ninety-two Thousand One Hundred Eighty-eight Dollars and eighty-seven cents ($92,188.87) stated by them to be based upon the Valley stop notices. Those would be a substantial part of the One Hundred Sixty-nine Thousand One Hundred Twenty-nine Dollars and seventy-six cents ($169,129.76) in claims. Were those claims contested? If not, why not? What was the basis of the other claims only a few of which were shown in the bankrupt's schedules.

We know that when Bailey and Allen settled with Valley the stop notices were released so that Bailey and Allen were paid by the University as much or more than they had paid to Valley. That left them with only the wholly contingent claim against the bankrupt depending entirely for its amount upon a determination of the loss to them because of being required to secure others to do the work. If the Twenty-six Thousand Nine Hundred Seventy-six Dollars and fifty-six cents ($26,976.56) owed by them to Thompson were in some manner paid or forgiven, no one has shown the details on that.

While it may be argued that the "adjudication" in bankruptcy cannot be collaterally attacked, it would not follow that the validity of the claims of petitioning creditors could not be collaterally attacked. Here the burden was upon the plaintiff to prove that there were persons with valid claims other than appellee and that appellee by the payments made to it was preferred to those others. At the trial appellant wholly overlooked this obligation of proof. The trial judge was persuaded by the appellant's own evidence (and lack of evidence) that there was no preference. This was in part because there was a complete failure to prove that there were persons with valid claims entitled to claim that there had been a preference of appellee over them.

VII.

Conclusion.

Appellant offers no legal basis for appeal. His contention appears only to be that the findings are not supported. He has avoided discussion of the evidence supporting the decision of the Court. He has applied false tests of the obligation of the claimed bankrupt.

Not only is it not true that the findings were clearly erroneous but it is true that any finding other than that made by the Court would have been "*clearly erroneous*".

Respectfully submitted,

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